AUGUST 2010

As they do every year, members of Congress spent most of August in their home districts or other places that are not Washington, D.C. Federal agencies continued to work through the capital's hottest month, though: the Securities and Exchange Commission approved rules that will make it easier for large shareholders such as CalPERS to nominate corporate directors; the trustees of the Social Security and Medicare programs produced reports that offered both good news and bad news; and the Government Accountability Office released a study in which it found that states and localities will face $10 trillion in budget shortfalls over the next 50 years. Congress returns to Washington on Sept. 13.

ISSUES AND EVENTS

SEC Votes to Give Shareholders Proxy Access
Companies will be required to put on proxy ballots the names of people nominated for director positions by significant long-term shareholders under rules adopted by the SEC on Aug. 25.

The rules approved by a 3-2 vote of the Securities and Exchange Commission (SEC) guarantee the ability of shareholders who own at least three percent of a company and have done so for at least three years to put nominees for up to one-fourth of a company's directors on the ballot. Shareholders may combine holdings to meet this threshold. Companies with a market capitalization of less than $75 million will be exempt from the rule for three years.

"As a matter of fairness and accountability, long-term significant shareholders should have a means of nominating candidates to the boards of the companies that they own," SEC Chairman Mary Schapiro said. "I have great faith in the collective wisdom of shareholders to determine which competing candidates will best fulfill the responsibilities of serving as a director. The critical point is that shareholders have the ability to make this choice."

The panel's two Republican commissioners voted against the proposal.

The move marks a significant victory for CalPERS and other shareholder advocates, who argue that proxy access is a key part of ensuring corporate transparency and accountability and who have worked toward enactment of such a rule for many years.

"This is ground-breaking for U.S. shareowners," said Ann Yerger, executive director of the Council of Institutional Investors. "Access to the proxy will invigorate board elections and make boards more responsive to shareowners and more vigilant in their oversight of companies."

The U.S. Chamber of Commerce and other business groups have long opposed expanding proxy access to shareholders, and Chamber officials have indicated that they may go to court to fight the new rules.

"Using the proxy process to give labor unions, pension funds and others greater leverage to try to ram through their agenda makes no sense," David Hirschmann, chief executive officer of the Chamber's Capital Markets Unit, said in a statement. He added that the organization "will continue to fight this flawed approach using every method available."

The SEC has backed away from previous proxy access proposals because of concerns about legal challenges, but the financial reform bill that became law in July included a provision that explicitly authorized the agency to enact such a rule.

Medicare Report Adds 12 Years to Trust Fund's Life, but Doubts Raised

Certain provisions in this year's health care reform law have extended the projected lifespan of Medicare's hospital trust fund by 12 years, according to the annual financial report released by the program's Board of Trustees on Aug. 5, though Medicare's own actuary has cast doubt on those estimates.

The Medicare trust fund is expected to last until 2029 – rather than 2017, as predicted last year – if the program-related measures in the "Patient Protection and Affordable Care Act" are enacted, the trustees concluded.

"It is clear that the Affordable Care Act is helping to strengthen the solvency of the Medicare trust fund and preserve this important program that millions of Americans rely on for their health care," Health and Human Services Secretary Kathleen Sebelius said. "In addition to the provisions of the new law cited in this report that will help make Medicare stronger, there are other important reforms going into effect that will help bring down costs and reduce fraud and waste in the system."

Actuaries for the Centers for Medicare and Medicaid Services last week released their own report that also extended the trust fund's exhaustion date until 2029 and identified $417.5 billion in Medicare savings resulting from the bill, with $350 billion coming from just two measures: aligning payments in Medicare Advantage plans to those in traditional Medicare and connecting provider payments to efficiency.

In the "Statement of Actuarial Opinion" at the end of the trustees' report, however, Richard Foster, Medicare's chief actuary, wrote that, while the methodology used in the report was sound, it is unlikely that the reforms will be implemented as written, which means, "the financial projections shown in this report for Medicare do not represent a reasonable expectation for actual program operations in either the short range … or the long range."

Foster, for example, described planned cuts of about 30 percent in physician fees as "implausible" and wrote that the savings projected for the provisions that would reward efficiency are unlikely to be realized because "most health care providers cannot improve their productivity to this degree – or even approach such a level – as a result of the labor-intensive nature of these services." He noted that the trustees would convene a panel of actuaries and economists to examine these issues and make recommendations regarding financial projections.

Republicans, meanwhile, argued that the projected savings are meaningless since the money has already been committed to new programs aimed at expanding health insurance coverage.

"Simple logic says that you can't spend and save the same dollar – but logic doesn't apply if you're a Democrat in Washington," House of Representatives Minority Leader John Boehner, R-Ohio, said.

The same trustees also oversee Social Security, and their forecasts for that program were largely unchanged from last year. Social Security's $2.5 trillion trust fund, they projected for the second year in a row, will be exhausted in 2037, at which point the program will be able to pay about 78 percent of benefits under current law.

The trustees predicted that Social Security expenditures will exceed revenues in 2010 and 2011, dip below revenues from 2012 to 2014, then permanently exceed revenues starting in 2015, a year earlier than projected last year. While the trust fund ensures the program's solvency for several more decades, it represents a strain on the federal government as a whole, since each year Congress uses the surplus Social Security taxes that form the trust fund for non-program spending and replaces the funds with IOUs.

"The fact that the costs for the program will likely exceed tax revenue this year is not a cause for panic, but it does send a strong message that it's time for us to make the tough choices that we know we need to make," Social Security Commissioner Michael Astrue said.

The 75-year shortfall for Social Security is estimated to be $5.4 trillion, or 1.92 percent of taxable payroll.

HHS Issues Grants to Enhance State Oversight of Health Premium Hikes

The U.S. Department of Health and Human Services (HHS) announced on Aug. 16 that it has awarded $46 million to 45 states – including California – and the District of Columbia to help them improve their oversight of health insurance premium increases.

Premiums, on average, have doubled in the past 10 years, according to HHS. One of the most notable recent planned rate hikes was announced in February when Anthem, a division of WellPoint, said that it would raise rates by an average of 25 percent – and as much as 39 percent – for holders of individual insurance policies in California. Anthem withdrew those plans following heavy criticism from members of Congress and others and the release of a report by an independent auditor commissioned by the California Department of Insurance that concluded that the rate proposal failed to meet the state's requirement that 70 percent of premium dollars be spent on medical benefits.

The grants are part of a five-year, $250-million program included in the recently-enacted health care reform law.

"States will use these grant dollars in the way that makes the most sense for their insurance consumers," said Jay Angoff, director of HHS' Office of Consumer Information and Insurance Oversight. "As we continue to implement the new health insurance reform law, we will continue to work with states to ensure they have the tools they need to ensure the stability of the marketplace, keep costs low and provide consumers with increased transparency, choice and quality they need to make the best health care decisions for their businesses and families."

California will receive $1 million, which it intends to use to:

- Improve coordination of premium review activities by the state Department of Managed Health Care and the California Department of Insurance (subject to legislative approval).
- Expand the number of carriers and rates subject to review to include all individual and small group premiums (subject to legislative approval).
- Improve the review process, with information technology and other enhancements.
- Make more of the information collected by the Department of Managed Health Care and the California Department of Insurance publicly available.

Bill to Require Shareholder Approval of Political Spending Advances

A House of Representatives committee on July 29 approved legislation that would give shareholders more influence over corporate political expenditures.

The House Financial Services Committee, by a 35-28 vote, sent to the full chamber the "Shareholder Protection Act" (H.R. 4790), which would require companies to hold an annual shareholder vote on how much money to spend on political activities. All Republicans on the panel opposed the bill, as did three Democrats.

The bill would not require a vote on the content or type of political advocacy.

The legislation is a response to the Supreme Court's "Citizens United" ruling in January, which struck down a long-time ban on political spending by corporations and unions.

"The Supreme Court decision effectively increases the influence of money in politics and diminishes the voice of the voter," Rep. Michael Capuano, D-Mass., the bill sponsor, said after the vote. "We should be working to limit outside influence on elections, not giving corporations a louder voice. My legislation is a simple and direct way to ensure that corporate political expenditures reflect the will of the shareholders, since the money in question belongs to the shareholders."

The bill would also direct the Securities and Exchange Commission to issue rules requiring corporations to disclose any materials for political activities created with or purchased using company funds and would hold officers and directors who authorize political expenditures without shareholder approval liable for three times the amount of dollars spent.

The legislation is opposed by business interests, with the U.S. Chamber of Commerce writing in a letter to lawmakers on July 27 that the bill "would encumber the free speech rights of the American business community, erode the business judgment rule, and infringe upon the traditional power of the States to administer corporate law."

"At its most basic level, the bill seeks to impose heightened burdens on corporate political decision making by requiring a shareholder vote before a company could engage in certain political activities," the letter states. "This burden is so onerous, time consuming and administratively challenging that few if any companies would likely even attempt to comply with it. This requirement would virtually ensure that most firms would be precluded from engaging in political activities."

The Chamber and GOP lawmakers also object that the bill would not impose similar requirements on unions engaging in political activities.

A vote by the full House is expected in September.

RELATED NATIONAL AND INDUSTRY NEWS

N.J. Charged with Securities Fraud Related to Pension Underfunding

The state of New Jersey on Aug. 18 settled without penalty charges by the Securities and Exchange Commission (SEC) that it engaged in securities fraud in a matter related to the funding of its public pension plan.

The SEC accused the state of failing to disclose in its bond offerings between August 2001 and April 2007 that it was underfunding its Teachers' Pension and Annuity Fund and its Public Employees' Retirement System. No New Jersey officials were named in the SEC's charges.

"All issuers of municipal securities, including states, are obligated to provide investors with the information necessary to evaluate material risks," said Robert Khuzami, director of the SEC's Division of Enforcement. "The State of New Jersey didn't give its municipal investors a fair shake, withholding and misrepresenting pertinent information about its financial situation."

The state agreed to accept a cease-and-desist order to settle the charges. It neither admitted to nor denied the charges.

This marks the first time that the SEC has filed charges against a state related to public pension funding, though the city of San Diego faced similar charges a few years ago.

"Hopefully," said Elaine Greenberg, chief of the SEC's Municipal Securities and Public Pensions Unit, "it will send a message to other states or local governments."

States, Localities Face Big Fiscal Challenges: GAO

State and local governments, in the absence of policy changes, will have combined shortfalls of about $10 trillion over the next 50 years, according to a Government Accountability Office report released on Aug. 13.

To eliminate the deficits, the GAO concluded, states and localities would need to reduce spending by 12.3 percent immediately – or raise taxes by an amount that would be equivalent to that – and maintain the adjustment for the next half-century.

In the short-term, the GAO found that state and local governments are expected to have deficits of $39 billion in 2010 and $124 billion in 2011.

Health care spending is the primary cause of fiscal challenges for governments, having jumped from 12 percent of state and local expenditures in 1978 to 20 percent in 2008 with cost increases expected to continue to outpace GDP growth, according to the report.

The report noted that pension and retiree health care costs represent significant financial demands on states and localities: asset values of public pensions dropped 27.6 percent from $3.2 trillion at the end of 2007 to $2.3 trillion at the end of 2008, and unfunded liabilities for non-pension post-employment benefits exceed $530 billion. The report addressed these topics only briefly, though, and mostly repeated previous findings on the subjects.

The report was prepared at the request of Rep. Paul Ryan, R-Wisc., a deficit hawk who is the ranking member of the House Budget Committee. The federal government provided $399 billion to state and local governments in 2008, and "Since many federal programs are implemented with state and local governments, fiscal pressures confronting the sector could affect implementation of federal programs and policies," the report noted.

Deficit Commission Looks at Taxes, 'Tax Expenditures'

The panel appointed by President Obama to craft a deficit reduction plan examined the U.S. tax code on July 28.

Members of the National Commission on Fiscal Responsibility and Reform heard various suggestions from witnesses regarding taxing and spending reforms, including advocacy of a value-added tax, repeal of the 2001 and 2003 tax cuts pushed through by President Bush – with a possible short-term extension until the economy is more stable – and a revision of the mortgage interest tax deduction.

"We have a tax system that really does not fit the circumstances we confront today, either in terms of generating revenue that is necessary or contributing to the competitive position that is absolutely critical for the country going forward," said committee member Sen. Kent Conrad, D-N.D., the chairman of the Senate Budget Committee.

One of the panel's Republicans, Rep. Dave Camp of Michigan, allowed that tax reducers such as the mortgage interest deduction – which are paradoxically known as "tax expenditures" – "clearly … is something we should look at," but added, "I don't think that alone will solve all of our problems." Camp's comment is one of very few from GOP members of the panel that indicate a willingness to consider tax increases.

Another commission member, Rep. Xavier Becerra, D-Calif., agreed that, "There may be things we have to do with any number of these tax expenditures," but he stressed that the panel should look at how its recommendations would affect various income groups.

Tax expenditures total more than $1 trillion a year – roughly three-fourths of the amount of the federal government's annual budget deficits and about equal to the amount the government collects in individual taxes.

Witness Barry Anderson, who has worked with the Office of Management and Budget, the Congressional Budget Office, the Government Accountability Office, the International Monetary Fund and the Organization for Economic Cooperation and Development, said another of the tax expenditures – the exclusion of employer-provided health insurance from taxation – not only reduces federal revenues but also contributes to high health care expenditures in the United States, a position long taken by Republicans. Regarding health care expenses, he also noted that medical and product liability costs are lower in other nations, and that countries with single-payer systems have lower administrative costs.

Anderson recommended that all spending and tax expenditures be subject to rules that would implement across-the-board cuts at certain points, a mechanism that he said European countries use.

The 18-member commission is charged with producing a set of recommendations by December that would eliminate the federal budget deficit – not including several hundred billion dollars in debt interest payments – by 2015. Congressional leaders have pledged to hold an up-or-down vote on the package before the next Congress is seated in January.

The panel is evenly divided between Democrats and Republicans, and 14 votes are needed to send recommendations to Congress. With Republican members of the commission opposed to tax increases and Democrats unwilling to cut spending on Social Security and other entitlement programs, it is unclear if the panel will be able to complete its assigned task. Commission Co-Chair Alan Simpson, a former GOP senator from Wyoming, in fact, recently judged the commission's odds of success to be "rather harrowing."

Separately, a new coalition announced on July 29 that it will work to oppose efforts by the commission to reduce spending on Social Security. "Strengthen Social Security" includes more than 50 organizations that argue that Social Security should not be cut, privatized or means-tested, that the retirement age should not be raised, that program shortfalls should be met by "requiring those who are most able to afford it to pay somewhat more," and that benefits should be increased for those who are "most disadvantaged."

"We have a message for the commission: Don't turn Social Security into the scapegoat for the deficit," said Gerald McEntee, president of the American Federation of State, County and Municipal Employees, a coalition member. "Social Security is not the problem. Don't raise the retirement age. Don't tamper with the [cost-of-living allowance]. If you break the promise that was made to America's working families, we'll hold you accountable."

At the commission's July 28 meeting, Co-Chair Erksine Bowles, the White House chief of staff during the Clinton administration, said that the panel "wants to strengthen Social Security, and we want to do it by ensuring that it's solvent for at least the next 75 years."